

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF)	
COLUMBIA GAS OF KENTUCKY, INC.)	CASE NO. 10201

O R D E R

On October 21, 1988, the Commission issued its Order in this proceeding. By petition filed November 10, 1988, Columbia Gas of Kentucky ("Columbia") requested rehearing on the following: prepaid nominated gas balances; construction work in progress accrual; deferred taxes; unbilled revenue - deferred tax debit; wages and salaries expense; uncollectible accounts; depreciation expense; income tax expense; cost-of-service zero-intercept methodology; and termination of IUS customers. By Order dated November 30, 1988, the Commission granted rehearing on all issues. A public hearing was held on February 23, 1989 and briefs were filed by March 30, 1989. After consideration of all evidence of record and being otherwise sufficiently advised, the Commission is of the opinion and finds the following:

MOTIONS

On February 6, 1989, Columbia moved to strike portions of the supplemental direct rehearing testimony of the Attorney General's ("AG") expert witness, Thomas C. DeWard. Columbia argued that portions of Mr. DeWard's testimony "must be stricken because it addresses matters not legally put into issue on rehearing or

contains legal opinions that cannot be the subject of witness testimony."¹

Prior to the taking of testimony at the February 1989 hearing, the AG moved to strike the "rate of return" testimony of a Columbia witness, Michael W. O'Donnell.² The grounds for the motion were the same as Columbia's grounds for moving to strike Mr. DeWard's testimony, i.e. rate of return was not put into issue on rehearing, and the witness's testimony contained prohibited legal opinions. The AG further indicated that if Mr. DeWard's testimony was stricken as outside the scope of rehearing or as stating legal conclusions, then Mr. O'Donnell's testimony must also be stricken.

After reviewing the testimony of each of the two witnesses, the motions, transcript, all other evidence of record, and being otherwise sufficiently advised, the Commission is of the opinion and finds that both motions should be granted. Mr. DeWard's testimony relating to: the calculation of revenue requirements associated with state and federal income tax; the determination of cash working capital; use of a single rate of return applied to

¹ Columbia's motion, page 2. Columbia references specific portions of Mr. DeWard's testimony which it requests be stricken as follows: page 2, line 7 through page 5, line 15; page 5, the sentence beginning on line 19, and concluding on line 20; page 7, the sentence beginning on line 13, and concluding on line 18; page 8, the sentence beginning on line 19, and concluding on line 22; page 9, lines 5 through 14; page 10, the sentence beginning on line 12, and concluding on line 15; page 10, the sentence beginning on line 18 through line 23.

² Transcript (Tr.), February 23, 1989, page 7.

Columbia's rate base; and the impact of investment associated with the Toyota plant are clearly outside the scope of rehearing issues raised in this proceeding and, therefore, should be stricken. Mr. O'Donnell's testimony is clearly rate of return testimony and as such should also be stricken. The Commission is of the opinion and further finds that the portions of both witnesses' testimony which contain legal opinions and conclusions should be stricken as improper subject matter for witness testimony. Accordingly, Mr. O'Donnell's testimony should be stricken in its entirety and the designated portions of Mr. DeWard's testimony (as specified in footnote 1, page 2) should be stricken.

REVENUE REQUIREMENT ISSUES

Rate Base Issues

Prepaid Nominated Gas. In its October 21, 1988 Order, the Commission reduced nominated gas balances to eliminate that portion attributable to cost-free accounts payable. This adjustment reduced Columbia's requested increase by \$220,446. This adjustment is identical to the treatment applied in Columbia's last litigated case, Case No. 9003.³ Columbia maintains that this issue was improperly decided in Case No. 9003 and argues that the premise upon which the decision was based is incorrect. Columbia maintains that the accounts payable associated with nominated gas balances do not represent cost-free capital.

³ Case No. 9003, An Adjustment of Rates of Columbia Gas of Kentucky, Inc.

Upon rehearing, Columbia has failed to establish that prepaid nominated gas balances should not be offset by accounts payable directly traceable to the nomination transactions. The Commission determined the appropriate treatment for these payables in Case No. 9003. The rationale for such treatment has been set forth and elaborated upon in the Order dated October 18, 1984 in Case No. 9003 and in the Order in the instant case dated October 21, 1988. The record in this case does not justify overturning this previously established practice. Therefore, the Commission finds that its October 21, 1988 decision on this issue should be affirmed.

Construction Work in Progress ("CWIP") Accrual. Columbia proposes to include in its rate base \$4,532,545 related to plant placed in service prior to the close of the historical test period, but booked to plant in service sometime following the close of business of the historical test period. In its Order of October 21, 1988 in this case, the Commission disallowed this proposal. Columbia in its petition for rehearing requested the Commission change its decision since the plant was in service prior to the end of the historical test year and prior to the date the original rates were effective. Although this plant was referred to as CWIP accrual throughout the case and the Commission continues to use this designation in this Order, it is important to note that the plant was in fact "in service" and that fact is central to the Commission's decision herein.

This presents a unique problem to the Commission. While the assets had been placed in service prior to the end of the test

year, they had not been booked to plant in service accounts and were not supported by cost-bearing capital at the end of the test year, but rather were temporarily supported by cost-free accounts payable. The Commission disallowed the adjustment in its October 21, 1988 Order because of matching problems and the fact that financing was not permanently secured. However, the Commission's concerns in its October 21, 1988 Order did not alleviate the fact that Columbia had placed in service a very significant level of used and useful plant, which was and is providing service to the public, prior to the close of the test period. Until this particular plant in service is included in the rate base, Columbia cannot earn a return on that plant.

The Commission has reviewed Columbia's monthly reports subsequent to the end of the historical test period and, based on that review, is of the opinion that Columbia is not in a position to earn greater than the authorized return in this case as a result of changes in operations during those months. The Commission believes that if it did not include this sizeable addition to plant in service in the rate base, the rates effective on and after the date of this Order would not permit Columbia the opportunity to earn its authorized return. The Commission does not consider this fair, just, nor reasonable. Thus the Commission is reversing its October 21, 1988 decision and will allow the accrued CWIP in rate base and is persuaded to make an exception to "traditional" rate-making and to allow the adjustment to plant in service.

This approach, however, is not a panacea to the problem of regulatory lag and matching problems during periods of significant additions to plant in service. The Commission believes that the best solution is to require the use of a forecasted test year. Therefore, in cases filed after this decision is issued, the Commission gives notice to Columbia and other utilities under its jurisdiction that: 1) adjustments for post test-period additions to plant in service should not be requested unless all revenues, expenses, rate base, and capital items have been updated to the same period as the plant additions; 2) it will accept a forecasted test period in lieu of the adjusted historical test period; and 3) if a forecasted test year is used in a rate case, the utility should also file historical test-period information for a 12-month period.

The Commission intends to complete its review of the necessary measures and issue guidelines for filing a forecasted test period on or about October 31, 1989. The Commission advises Columbia and other utilities under the Commission's jurisdiction that it will not accept a rate case based on a forecasted test period until guidelines are issued. During the interim period, prior to the issuance of these guidelines, the Commission will consider requests for post test-period additions to plant in service on a case-by-case basis.

Accumulated Depreciation. Consistent with the decision on accrued CWIP the Commission has adjusted accumulated depreciation to reflect one year's depreciation.

CWIP Accrual - Deferred Taxes. As described in other sections of this Order, accrued CWIP and the depreciation expense associated with those assets have been included.

Unbilled Revenue - Deferred Tax Debit. The Commission denied Columbia's proposed treatment of the additional tax liability resulting from the unbilled revenue rules of the Tax Reform Act of 1986 ("TRA"). This adjustment was denied because rates are set based upon book income tax expense. While this TRA rule will increase income calculated for tax purposes, there will be no effect on pre-tax book income or book income tax expense. During the rehearing, Columbia proposed that it should at least be accorded the same treatment of unbilled revenues as was applied in the TRA cases in 1987. In the TRA proceedings, recognition was given to the fact that the new unbilled revenue rules will create an actual tax liability greater than book income tax expense, which will generate a deferred tax debit. This deferred tax debit will serve to reduce deferred taxes which will result in an increase in rate base. The Commission gave recognition to this increase in rate base in the TRA proceedings in 1987.

As noted subsequently in this Order, the Commission affirms upon rehearing its treatment of the TRA rules as they relate to income tax expense. Moreover, the Commission is of the opinion that no rate base adjustment should be made related to the TRA unbilled revenue rules. The Commission finds that such treatment was unique to the generic 1987 TRA cases and is inappropriate for application in a general rate proceeding. While Columbia is an

exception in that a final TRA Order was never issued, the ramifications of TRA were specifically included as a part of the settlement process in Case No. 9554.⁴ Thus, general rate proceeding treatment should be the same for Columbia as for the utilities that did fully participate in the TRA proceedings. For such utilities, no unbilled revenue adjustments have been made in rate proceedings occurring subsequent to the TRA proceedings; therefore, the Commission finds that no such adjustment should be made in this proceeding.

Expense Issues

Wages and Salaries. In its October 21, 1988 Order, the Commission disallowed Columbia's proposed \$393,440 adjustment for a wage increase scheduled to occur 11 months subsequent to the test period. On rehearing, Columbia argued its position that this adjustment is appropriate because it is known and measurable, is a necessary adjustment to create a proper matching of revenues and expenses, and because the Commission allowed a similar adjustment in Case No. 8281⁵ with respect to union wages.

The Commission does not dispute the fact that an adjustment could be determined which would apply the December 1988 wage increase to test-year payroll; however, an adjustment to wages and salaries goes beyond the application of wage increases to test-

⁴ Case No. 9554, An Adjustment of Rates of Columbia Gas of Kentucky, Inc.

⁵ Case No. 8281, An Adjustment of Rates of Columbia Gas of Kentucky, Inc.

year wages and salaries. The Commission utilizes the historical test period adjusted for known and measurable changes in determining revenue requirements. The criteria of known and measurable go beyond the mathematical exercise proposed by Columbia. While the wage levels in this instance may be known, there are other factors affecting wages and salaries which are subject to change over a period of 11 months. The growth in utility customers may result in the addition of employees or restructuring of the work force. On the other hand, a certain amount of productivity increase should be achieved through the implementation of higher wages and salaries. These concerns would not be reflected in the adjustment proposed by Columbia. An additional concern is the mismatch of revenues and expenses created by projecting wage increases which will occur 11 months beyond the end of the test period while not providing any additional revenues for customer growth which will occur subsequent to the end of the test period. The Commission acknowledges that there are certain limitations caused by the use of an historical test period which could be remedied through the use of a future test period. However, under the circumstances in this case, it would not be appropriate to include the adjustment for wage increases occurring 11 months beyond the end of the test period without fully recognizing other post test-period occurrences. Therefore, the Commission affirms its October 21, 1988 decision of this issue.

Unbilled Revenues. In the Order of October 21, 1988, the Commission denied Columbia's proposal to recognize as an expense for rate-making purposes the \$570,000 additional tax liability

that will result from the new TRA Unbilled Revenue rules on the premise that these rules will not impact regulated pre-tax book income or regulated book income tax expense. Upon rehearing, Columbia has failed to demonstrate that this premise is incorrect. Therefore, the Commission affirms its decision of October 21, 1988. (Further discussion of this issue is contained on page 7 of this Order.)

Uncollectible Accounts. In its October 21, 1988 Order, the Commission disallowed a \$118,212 adjustment proposed by Columbia to reflect the amortization over 3 years of Johnson County Gas Company, Inc.'s ("Johnson County") and Martin Gas, Inc.'s ("Martin") wholesale gas arrearages.

The Commission finds that recovery of the Martin and Johnson County arrearages from general ratepayers is inappropriate at this time because such action would be premature and because the allowance would be inconsistent with actions taken in recent and current dockets before the Commission. In recent months, the Commission Staff has audited and filed reports relating to both Johnson County and Martin. These reports have recommended revenue requirement levels which specifically include a provision for repayment of the arrearages to Columbia. Moreover, the record indicates that both companies have made recent payments toward extinguishing their arrearages, and thus there is doubt about the amount of the arrearages which are uncollectible.

It should further be noted that Columbia proposed and the Commission denied a similar adjustment in Case No. 9003 on the

basis that the ultimate portion of the arrearages that was uncollectible was not known and measurable. The Commission believes that the ability to collect these arrearages remains undeterminable and it is premature to determine that these arrearages are uncollectible. The Commission, therefore, affirms the finding in its October 21, 1988 Order that amortization of these arrearages be denied.

Depreciation Expense. In conjunction with the Commission's October 21, 1988 adjustment to exclude accrued CWIP, an adjustment was made to eliminate the associated depreciation expense which Columbia had proposed to include in rates. The Commission in this Order has reversed its decision on accrued CWIP and correspondingly reverses its decision on depreciation expense associated with that plant. Since \$139,383 was excluded from depreciation expense in the October 21, 1988 Order, this amount has been reinstated herein.

REVENUE REQUIREMENTS SUMMARY

Based upon the above revenue requirements discussion, the Commission finds that Columbia should be granted additional revenues of \$792,037. Following is a recap of this determination:

CWIP Accrual - Return	\$673,362
CWIP Accrual - Depreciation	139,383
CWIP Accrual - Accum/Dep.	< 20,708 >
Total	<u>792,037</u>

Cost-of-Service Study - Zero-Intercept Methodology. Columbia was granted rehearing on the Commission's decision to require Columbia to maintain the data necessary to perform an accurate zero-intercept procedure in its cost-of-service studies. Columbia

contended that the nature of existing property records impairs the validity of a cost study based upon the zero-intercept methodology. They asserted that the problematical records deal with main sizes that are no longer in use and were installed many decades ago at a very low average cost per foot by current standards. Columbia, therefore, contended that it was impossible to maintain such records.⁶

The Commission has stated in previous Orders that the zero-intercept methodology is an acceptable way to determine the customer component of distribution main costs, is theoretically sound, and is less subjective than other procedures.⁷ Furthermore, in Case No. 10064, Louisville Gas & Electric Company presented a well-documented and thorough zero-intercept study with no reference to problems arising from the use of old property records and main sizes that are no longer in use.

The Commission is acutely aware that a zero-intercept study, which analyzes the relationship between main size and unit cost, involves the use and analysis of old property records pertaining to the installation of mains. The Commission's adopted Uniform System of Accounts Prescribed for Natural Gas Companies ("USoA") includes, in Subchapter F, Part 225, a schedule of records and

⁶ Case No. 10201, Application for Rehearing or Reconsideration of Columbia Gas of Kentucky, Inc., page 20.

⁷ Case No. 10201, Commission Order dated October 21, 1988, page 53; Case No. 10064, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company, Commission Order dated July 1, 1988, page 80.

periods of retention. If Columbia is adhering to the records retention portion of the USoA, the Commission feels that the property records necessary to perform a zero-intercept study should be readily available. Furthermore, Columbia has not sufficiently shown why these records cannot be maintained.

The Commission, therefore, affirms its decision to require Columbia to maintain the data necessary to accurately perform a zero-intercept study, as well as other commonly accepted cost-of-service methodologies and procedures. Furthermore, the Commission is of the opinion and finds that Columbia should perform a zero-intercept study as part of the cost-of-service studies presented in all future rate cases. Columbia has stated that, if so ordered, it can perform a zero-intercept study if the Commission allows Columbia to disregard problematical data.⁸ The Commission is of the opinion and finds that Columbia should fully document all aspects of the zero-intercept study, especially the inclusion or exclusion of perceived problematical data. Columbia should completely assess the effect this data has or would have had on the results of the zero-intercept study and thoroughly describe the nature of the problematical data, including, if applicable, the reasons why Columbia cannot maintain the data.

TERMINATION OF IUS CUSTOMERS

In the Order of October 21, 1988, the Commission denied Columbia's request to delete from its tariff the requirement that

⁸ Case No. 10201, Rehearing Brief on Behalf of Columbia Gas of Kentucky, Inc., page 30.

it obtain Commission approval prior to terminating service to IUS customers for non-payment of bills. Columbia requested reconsideration of this issue, arguing that without the authority to terminate service, it could not enforce collection of past due bills.

The Commission understands Columbia's past problems involving IUS collections and intends to be more responsive to any future collection problems; however, the Commission is not persuaded to alter its position on this issue. The retail customers served by Columbia's IUS customers would also be subject to termination, and for that reason, the Commission believes its responsibility to those customers requires that Columbia's request be denied. The Commission hereby affirms its October 21, 1988 decision on this issue.

IT IS THEREFORE ORDERED that:

1. The motion of Columbia to strike specifically designated portions of the testimony of Mr. DeWard is granted.

2. The motion of the AG to strike in its entirety the testimony of Mr. O'Donnell is granted.

3. Columbia shall be authorized to collect and receive additional annual revenues of \$792,037 as enumerated herein and as shown in Appendix A, attached hereto and incorporated herein.

4. The Commission directive as specified in its October 21, 1988 Order in this case that Columbia shall maintain the data necessary to accurately perform zero-intercept studies, minimum-intercept studies, as well as other procedures that will enable Columbia to present a well documented multiple-methodology

comparison in its next cost-of-service study is hereby affirmed. Further, Columbia shall perform a zero-intercept study as part of the cost-of-service studies presented in all future rate cases.

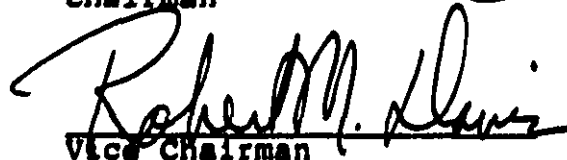
5. Columbia's request to delete from its tariff the requirement of obtaining Commission approval prior to terminating service to IUS customers for nonpayment of bills is denied.

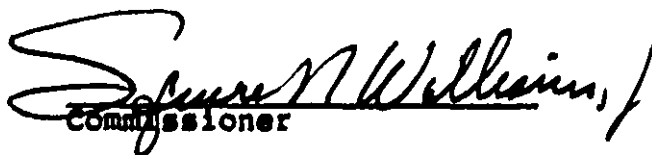
6. All other recommendations, findings, and Orders of the Commission as set forth in its October 21, 1988 Order not specifically addressed herein remain in full force and effect.

Done at Frankfort, Kentucky, this 23rd day of August, 1989.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 10201 DATED 8/23/89

The following rates and charges are prescribed for the customers served by Columbia Gas of Kentucky, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

CURRENTLY EFFECTIVE BILLING RATES

	Base Rate Charge \$	Gas Cost Adjustment \$	Total Billing Rate \$
RATE SCHEDULE GS			
Volumetric:			
First 2 Mcf/Month	1.4103	3.4461	4.8564
Next 48 Mcf/Month	1.3803	3.4461	4.8264
Next 150 Mcf/Month	1.3503	3.4461	4.7964
All Over 200 Mcf/Month	1.3203	3.4461	4.7664
Delivery Service:			
Firm	1.3203	.0373	1.3576
RATE SCHEDULE FI			
Commodity Charge:	0.4423	3.4461	3.8884
Delivery Service:			
Interruptible	0.4423	.0373	.4796
RATE SCHEDULE IS			
Commodity Charge	0.4423	3.4461	3.8884
Delivery Service:			
Interruptible	0.4423	.0373	0.4796
RATE SCHEDULE IUS			
For all Volumes			
Delivered each Month	0.1211	3.4461	3.5672
Delivery Service	0.1211	0.7907	0.9118